RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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APRIL 7, 1982 **LETTER 832**

Mar. 26, DJIA 817.92; PTI 1332; A-D Ratio –25.75
Apr. 2, DJIA 838.57; PTI 1344; A-D Ratio –25.40

THE PICTURE: I've read about a million pages of investment advisory output over the past 35 years, and I'll let you in on a strange little secret. The secret is that very FEW people in the advisory business really believe what the market is telling them. I would estimate that there are only about thirty people in this industry who know how to read the markets, and of that thirty maybe ten believe, I mean truly BELIEVE, the message of the market.

Consider this: on July 2 the Dow Theory signaled a primary bear market. The signal was widely ignored at the time, and I was amazed when most of the advisory services failed even to mention the signal. The only periodical in the nation to note the Dow Theory bear signal was Barron's, and that was in a passing remark in a weekly column.

More recently all the major stock averages broke below their important September, 1981 lows. I accepted this as a re-confirmation of the primary bear trend. But aside from the stock market, we have (over the past two years) witnessed smashes in gold, silver and platinum, the "strategic metals," precious stones (including diamonds), commodities and bonds. We have also seen dramatic weakening in home prices, farm land, collectibles of all kinds and world oil prices.

Despite this carnage, despite the fact that the primary trend of the stock market continues down, the most popular subject around is "what month the economy will turn up?" Instead of taking the warnings of the markets seriously, the politicians, the public, the President and yes, the investment community–focus almost all their attention on the "coming turn to the upside."

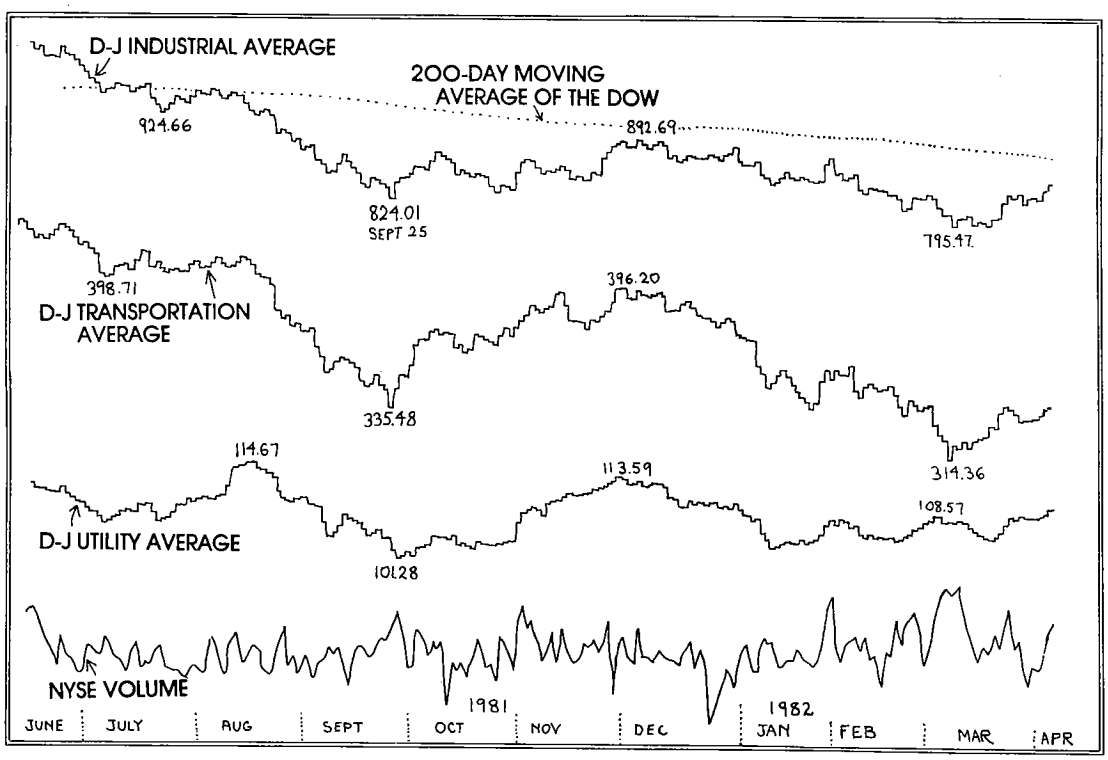
FRONT PAGE COMMENT: Most people think that the debt problem is strictly an American river of red. Wrong, it's a world ocean of red. Did you know that the external debt of the developing nations has grown from $87 billion ten years ago to $524 billion today? Also, 75% of these loans are at floating rates, so that if interest rates rise, so do the payments. Did you know that over 45% of the various banks' international loans (at the end of June, 1981) were due to be paid in less than one year? What do you think a world recession is going to do for the debt-servicing capabilities of the various debtor nations? Right, it's going to kill their capacity to service loans.

Meanwhile, my "World Index" chart shows the profile of a world bear market–with the World Index breaking decisively below its September lows. Confirming the world bear market, international trade volume dropped in 1981–for the first time since 1958!

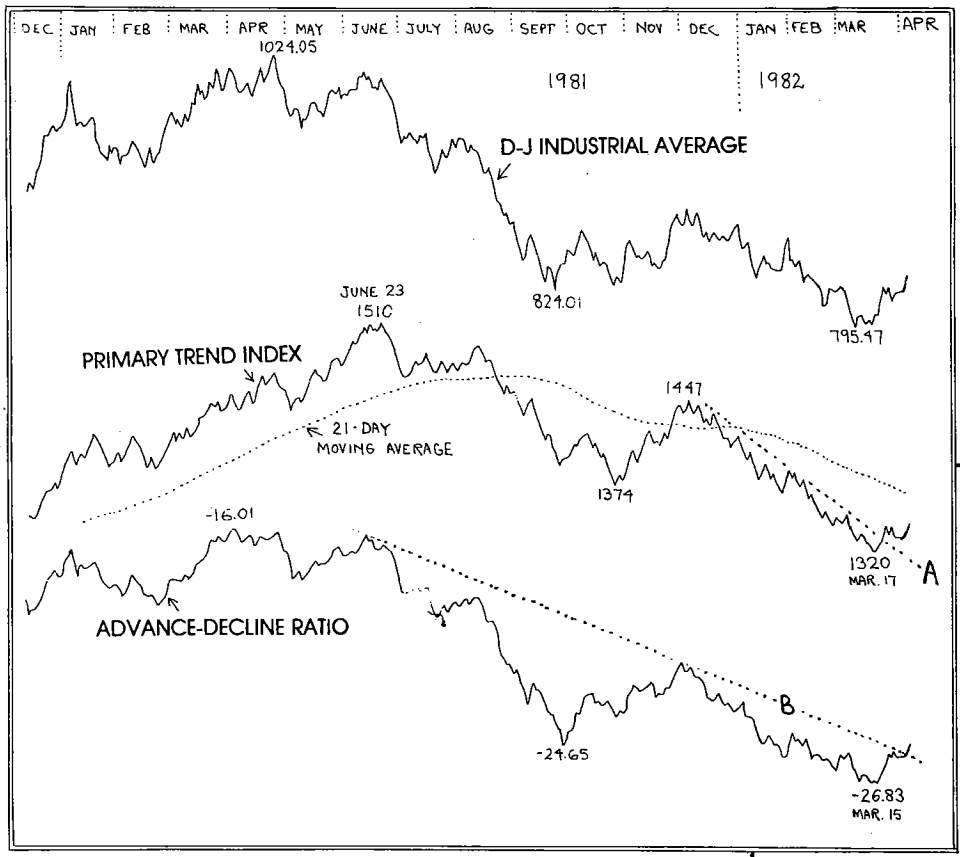
Special to THE WALL STREET JOURNAL

GENEVA–World trade volume was stagnant in 1981, due largely to weak demand for petroleum, and its value fell for the first time in 23 years, according to the General Agreement on Tariffs and Trade.

Now I don't want to stifle optimism, and I don't want to be the great kill-joy. But I place my credence and faith in the markets, not the promises of politicians or the guesses of "experts." It seems clear to me that the markets have said "stormy weather ahead," and as long as that's the message, Richard Russell's subscribers will be hearing about safety, conservation of capital and the wisdom of holding T-bills. You see, I absolutely do believe the message of the market. True, the market never pinpoints anything for us, and the market doesn't give us specific instructions for living. For instance, the market doesn't say, "guaranteed collapse in July, 1982," and it doesn't announce, "Buy only short-term Government paper." But the market has said, "The great tide of stocks and the economy is down," and until that message is countermanded, you'll be hearing caution out of La Jolla, California.



THE MARKET: The D-J Industrial Average sells for 7.2 times earnings and yields 6.8%. My friend, Ned Davis (Ned Davis Research) notes that at current prices, the Dow is selling 19% under its 1981 book value (he estimates the 1981 book value at 982). This is the lowest the Dow has sold



(in relation to its previous year's book value) since 1936, says Ned.

The Dow is "cheap." But cheap compared with what? The bear notes that the yield on the D-J 20-Bond Average is now 14.63%, a fat 7.8% above the yield on the Dow. In other words, dividends would have to more than double before the Dow offered the same return as bonds. "But what about inflation," you ask, "won't stocks outperform bonds if inflation takes off again?" And the answer is probably, but suppose inflation doesn't take off again. Suppose today's disinflation turns into net deflation? In that case stocks would appear extremely expensive in comparison with bonds.

All of which shows why I pretty much stick to analysis of the ACTION of the market. I let the market tell me what to expect next. That policy has kept me out of a lot of trouble.

Turning to the page 1 chart of the Averages, we note that the last important lows were recorded on March 8, with Industrials at 795.47 and Transports at 314.36. Since then, the Averages have been rallying. The rally has been slow at getting started, and it has not been accompanied by any spectacular gains in breadth. But the bears have had a long time at bat (since April of 1981), and now it is time to see what the bulls can do with the situation.

From an intermediate-term standpoint, the bulls have already accomplished two things. Note on the page 2 chart that the Primary Trend Index's four month downtrend (marked A on the chart) has been reversed to the upside. This places the PTI in position to approach its 21-day moving average which now stands at 1368. Secondly, the A-D ratio (a proxy for all the stocks on the NYSE) has reversed a nine-month downtrend, and I would expect some sort of decent rally on the part of the A-D from here.

Most people get locked into a set view of the market, and they tend to forget a basic principle of Dow Theory. That principle states that every movement in the Averages (whether primary, secondary or minor), is entitled to a one-third to two-thirds correction. Thus, downward corrections will occur within the most powerful bull markets. And upward corrections will appear within the most disastrous bear markets. The correction acts as the "escape valve" in the market boiler; it allows Wall Street to let off steam. The correction also serves to chastise amateur speculators and greedy traders. It dampens their enthusiasm and whittles down their gains (and alas, it often turns speculative paper profits into real losses).

INVESTMENT POSITION: Our investment position (as it has been since last June) is one of thwarting the bear. Our method of thwarting the bear is to stay out of the various markets, including the stock market, the commodities markets, the precious metals markets and the collectibles market. "A house," you ask, "what about my house?" A house is different. Your house may not be an investment any longer, but it is shelter. So I tell subscribers, "If you like your house, if you need your house, if you enjoy living in your house–by all means, keep it."

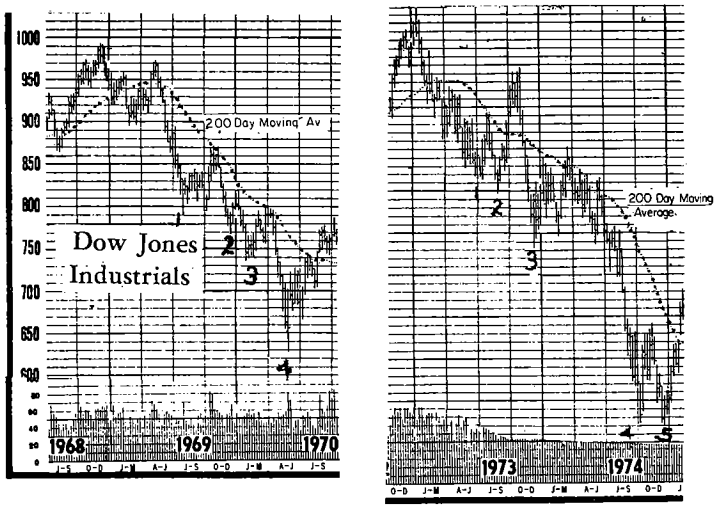
Meanwhile, the bear is in charge. And he has one tremendous weapon at his command. That weapon is PATIENCE. The bear is patient, and investors grow careless–and even optimistic. This is what the bear hopes for. Remember, a bear market wants to go down–while taking the MOST number of investors and speculators with it.

Our basic weapon against the bear is T-bills. Buy them, roll them over, and collect over 13% while you're waiting.

MOVING AVERAGES: One of the oldest technical market studies, and one of the most useful, is the study of price action as related to the moving averages. E. George Schaefer, the great Dow Theorist (he wrote during the 1950's to early 1970's) made extensive and brilliant use of the 200-day moving average of the Dow. Schaefer used to call this his "investment line." Prior to Schaefer, Harold Gartley (writing in the 1930's) made extensive use of various moving averages. But of all the practitioners, I found Schaefer's moving average studies most useful.

It was Schaefer's thesis that the Dow tends to hold above its 200-day MA throughout a primary bull market (except during violent secondary reactions, when the Dow may temporarily break below the 200-day MA). By the same token, during a primary bear market the Dow will tend to hold below its 200-day MA (except during powerful upward corrections, at which time the Dow may temporarily climb above the 200-day MA).

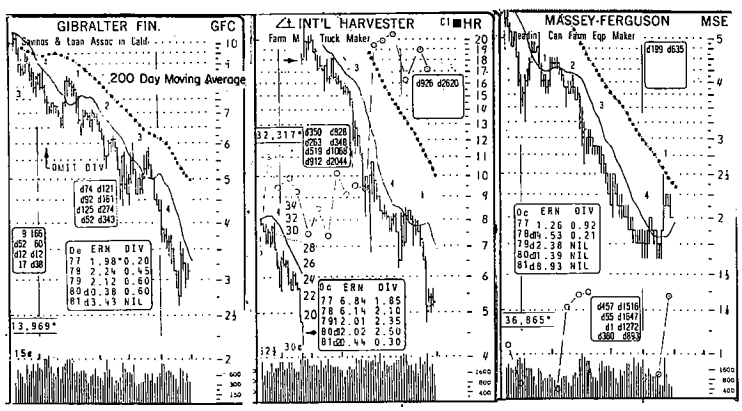
I should add, however, that it's far more common for the 200-day MA to halt the progress of any movement that is counter to the primary trend. In the current situation, for example, the 200-day MA of the Dow stands at about 885. Therefore, I would



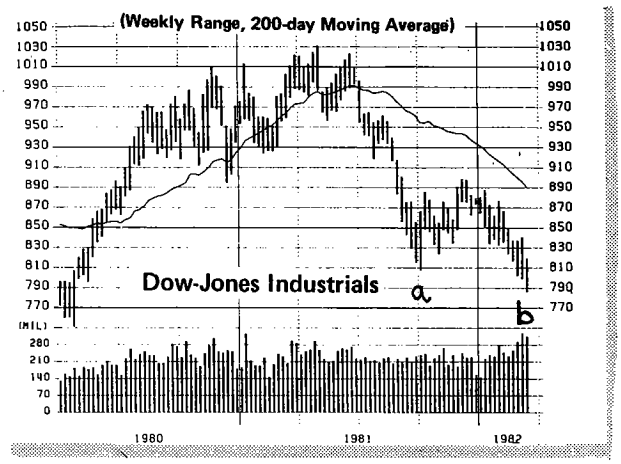
expect any rally to terminate on this side of the 885 level. Significantly, the last peak in the Dow occurred at 892.69 in December. Thus, on two counts there should be tremendous resistance at the 885-890 level in the Dow.

I have included three charts, charts which portray some of the major Dow declines (together with the 200-day moving average) of the last dozen years. Note that the declines become serious once the 200-day MA turns DOWN. Note also that during the final leg down in 1970 and again in 1974 the Dow fell far below its 200-day MA. During 1969-70 the Dow recorded four separate downside plunges (following the downturn of the 200-day MA) before the bottom was reached. I have numbered these plunges on the chart. During 1973-74 we witnessed five separate plunges before the final bottom was reached. In the present instance, we have seen two downward plunges so far, marked A and B on the chart. (The 1980-82 chart is courtesy of the Holt Advisory in Westport, Conn).

Joe Granville, one of the few analysts who understand the correct use of the moving average, refers in a recent report to the "railroad track" phenomenon. This is the situation wherein the price moves down in tandem with the 200-day MA. This is a most bearish phenomenon, and it can be seen in such individual disaster stocks as International Harvester, American Motors, Gibralter Financial, Massey-Ferguson, Braniff Int'l (charts courtesy of Chartcraft, PO Box 213, Wichita, KA 67201).



What causes the railroad track pattern? It is the steady erosion of values, an erosion so persistent that the price and the 200-day moving average decline almost as though locked together. Such declines are invariably omens of severe trouble to come, and stocks in the railroad track pattern often move towards the edge of bankruptcy.



QUESTIONS & ANSWERS: This is a continuation of Q's and A's from the last Letter: Question: Russell, what's the best investment book I can buy at this time?

Answer: The best investment book you can buy right now is "Compound Interest and Annuity Tables" (McGraw Hill paperbacks, $4.95). There is only one SURE way to get rich. That sure way is to invest your money in safe instruments at attractive rates of COMPOUND interest. Therefore, I recommend that everyone study compound interest tables. For example, if you invest $100,000 at 6% in a 30 year bond and you reinvest the interest at 6% annually, at the end of 30 years you will have a total of $589,000. If you buy a 30 year bond at today's prevailing rate of 14% and you invest the proceeds annually at 10%, at the end of 30 years you will have $2,575,081. If you take that same 14% 30 year bond and invest the proceeds annually at 14%, at the end of 30 years you will have $5,794,640. This is assuming that you do this without taxes (say in a pension plan or IRA).

Note that one of the major factors in compounding is TIME. That is why I emphasize to all my younger subscribers, USE TIME. Start an account immediately at compound interest (separate from all your stock transactions) and simply compound your funds in safe instruments. This is the sure road to wealth (barring a collapse of the currency or a revolution).

Remember this: with true inflation rates at around 3% today, and with safe returns of 13-15% obtainable on a variety of credit instruments, you can get a real return of better than 10%. This is one of the highest real return rates in history.

Question: With business sliding, why aren't interest rates collapsing as predicted by all the leading economists?

Answer: In a word: DEBT. The cost of servicing the unbelievably high levels of debt in the US (total debt of all kinds–over $5.4 trillion) is keeping rates high. Worse, the debts continue to climb in all areas, and as noted in the last Letter, the Government has just added another $53 billion to the Federal debt. This is all being compounded at the highest interest rates in history, thus not only is the debt rising but the cost is rising–exponentially.

At the corporate level, liquidity is the worst since World War 11. Economist Lacey Hunt of the Fidelity Bank (Philadelphia) notes that at year end, after paying dividends and capital spending bills, corporate cash flow (adjusted for inflation) was minus $101 billion, a horrendous cash flow situation. Hunt believes that this negative cash flow situation guarantees that there will be no real recovery in capital spending–and that interest rates will stay high. Even as this is written, the corporate bond calendar is ballooning to massive levels. Every corporation, it seems, wants to get on the money line.

Question: I buy my T-bills through a brokerage house. What happens if my broker goes belly up?

Answer: Make sure that your broker has created a separate account to hold customers' T-bills, an account that is NOT co-mingled with the brokerage house's assets. T-bills are bought in wholesale quantities by the broker and then allotted to the customers (there are no physical T-bills, they are bookkeeping entries with the Fed). But if the broker has correctly set up a separate account for T-bills, you are safe–regardless of the fortunes of your broker.

Question: Russell, you state that we are in a primary bear market. You say you believe the markets. Then why don't you recommend shorts for your subscribers–or at least puts?

Answer: Here we go again, a question I've been asked a thousand times. I don't recommend shorts or puts because through my experience of over 25 years as an investment advisor I have learned that 80% of my readers lose money in shorts and puts (and calls, for that matter). When you buy an option or take a short position you are speculating, pure and simple. You are also speculating against TIME. Most people are bum speculators, and the added pressure of time makes them even worse practitioners.

In these letters I try to teach people how to read the markets and how to invest in harmony with the markets. People seem to do fine in bull markets when they invest, collect their dividends and dream happy, bullish thoughts. But in bear markets people go short, buy puts, get killed in bear market rallies, and in general, lose money. Don't ask me why 80% of investors and speculators can't beat a bear–but they can't. Remember, too that in a bear market you're taking your after-tax money and trying to garner short-term gains (all the while paying out dividends). You are also combing the newspapers for bad news. All this seems too much for the average person.

Another factor: mathematics are against you on the short side. If you short 10 stocks, the most you can make on any single short is 100% (that's if the stock goes broke and sells at zero). But if you buy 10 stocks in a bull market, one or two of those stocks are probably going to rise 100% to 500% and thereby bring your average gain way up. In other words, there's no limit to how much you can make (percentage-wise) in a bull market. In a bear market you can't make more than 100% on the short side.

Finally, remember that in a bear market values are diminishing through time. Thus, if you hold CASH (T-bills) that cash is worth more and more in terms of stocks, houses, bonds, gold, collectibles–as time goes buy. Cash in a bear market is a type of short sale. Conclusion: In a bull market buy stocks; in a bear market (if you are a Russell subscriber) hold cash. Forget the shorts, forget the options, we're not playing games at Vegas, we're building assets. To build assets we utilize a number of items: (1) our brains, (2) time, (3) money, (4) knowledge of the primary trend, (5) probabilities. And probabilities tell us that almost all gamblers and most speculators wear patched pants.

Question: All that may be true, Russell, but there are still people who want to buy puts and put out shorts. Wouldn't your service be more popular if you listed shorts as so many services do?

Answer: Maybe, but I'm not running a short-term popularity sheet. I've run Dow Theory Letters for 25 years according to my conscience and my firm belief that people (deep in their guts) appreciate good, honest, profitable advice. I'm providing the best advice I'm capable of, and I mean every word I write. When it comes to investing, I'm giving you the results of hard practical experience. I know what "could be done" with shorts if "this" and "that" were done. I'm saying, it usually isn't done. But try it, a lot of people only learn the hard way.

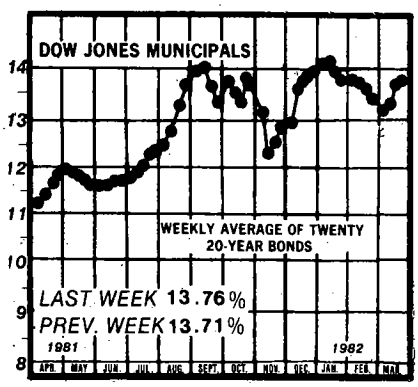
Question: Russell, I have 90% of my funds in T-bills. But how safe are the T-bills? Won't the Government ultimately find its debt unsupportable, and won't it then renege on that debt?

Answer: I don't think the Government will renege on its debt. I think at a certain point, the markets will force sanity upon the Government. At that time we will have a LAW dictating a balanced budget. This will let politicians off the hook and force an end to deficit madness. At that time each Congressman and Senator will be able to say, "Look, I was all for this spending program, but the new law has cut if off. I wanted it, honest, but....."

Question: All right, but without deficits and out-of-control spending, wouldn't the country go into depression?

Answer: Yes, but it would also have real money, money people trust. The depression is coming anyway, and I'd rather have a depression with honest money than a depression with collapsing dollars.

MONEY: The easy time is past for the Federal Government. From now on, financing needs will be massive. On top of this, state and local government needs are rising, due to the shortfalls on tax receipts and due to cut-offs of funds for the states. For instance, California (now two-thirds into its fiscal year) is experiencing a deficit of $1.8 billion.



All this means a huge desire to raise money in the weakest area of the money market–the municipal bond sector. This WSJ chart shows the story in the muni's and what we see here is a push towards record high yields on the D-J Municipal Bond Average. Weakness in Muni's will put constant pressure on the rest of the bond market. After all, with tax-free income around 14% how are you going to sell industrial bonds at 12% or less? The answer is that you can't. Keep your eye on the Muni market. This is the Achilles Heel of the money picture.

NOTES & QUOTES: I've studied the Ford and GM "new agreements" with the UAW. In my opinion, these agreements were "losers" for the companies. I don't see where productivity will be improved at all. Meanwhile, the unions got a two-year moratorium on plant closings, a degree of job security for senior workers and a profit sharing plan. The Japanese can STILL produce cars for roughly $1500 less per unit. And note, any concessions Ford and GM received did not help in lowering US car prices. All the concession may do is help get the big companies into the black.

* *

From our "What Else Is New?" Dept. The latest news out of Washington (let's call it the weekly non-news event) is that the

Reagan Administration is revising its deficit estimates upwards. My current guess as to the outcome–the 1982-83 budget will (with off-budget expenses) hit over $150 billion in deficits.

By WILLIAM J. EATON, *Times Staff Writer*

WASHINGTON—The Reagan Administration may revise its budget forecast soon to show even larger deficits in the future than President Reagan projected on Feb. 9, Administration sources said Monday.

The outlook for red-ink spending is worse because the recession has been deeper and is lasting longer than the White House expected, the sources said.

There was no immediate indication of how much the revised deficit for fiscal 1983 would increase from the record-high level of $96.4 billion now estimated by the Office of Management and Budget.

* *

Last week the London Economist presented another one of its great articles, this time on International Banking. The Economist states that there are now 25 countries who are "re-scheduling" their debts (which means they can't pay them on time, if at all). Total involved: $6.8 billion. What does re-scheduling do for the banks? It gives them room to hope, but more importantly, it keeps massive losses off the books–for awhile.

* *

From our "What Else is New?" Dept:

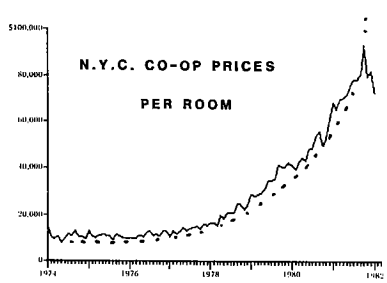
Faced with dwindling revenues, recession and unemployment, 26 states are considering tax increases totaling nearly $7 billion this year, the Tax Foundation reported. The proposed hikes could set a record total for the last 10 years, according to a study the non-profit organization released in Washington. Last year, state lawmakers approved $3.8 billion in tax increases.

* *

Harper & Row has published a FASCINATING book entitled, "Everybody's Business" by Moskowitz, Katz and Levering ($9.95, paperback, 914 pages). The book presents extraordinary profiles of over 300 major American corporations. Each profile is a treasure trove of information, including all kinds of fascinating tidbits such as (1) Gail Borden, founder of Bordens, had his gravestone carved in the shape of a condensed milk can. (2) Clarence Barron bought the Wall Street Journal from Dow and Jones in 1902. Barron, who founded Barron's in 1921, was 5'6" and weighed 300 pounds. (3) Of the roughly 1 million cars stolen annually in the US, 10% or 200 are stolen in NYC–every day. (4) Coca Cola uses 10% of all the sugar consumed in the US. Buy this book. You'll love it, and you'll learn.

* *

Addition to my studies of parabolic curves: this chart of the price of a co-op (per room) in NYC. The price peaked last October at the astronimical price of $93,261 per room! Since then prices have sunk to just over $70,000 per room.



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ALL RIGHT: My high school class (Horace Mann, 1942) is having its 40th reunion next month, and I'm going to the Big Apple to attend. I've been helping one of my oldest buddies, Jay Pack, track down some of the 90 members of the class. There was a quiet, serious little guy in the class named Warren Phillips. He was on the track team with me (I was a sprinter), and Warren was a surprisingly good hurdler. We list him on the class roster as working for Dow Jones. Jay checked with me last night. "Hey, I called Dow Jones to get hold of Phillips. You know what he's doing there?" "Yeah," I cracked he's night janitor, and he doubles as copy boy." "Wrong, said Jay, "He's Chairman of the Board of Dow Jones." "You're kidding, Warren?" Belated congratulations, Warren. But on April 30, forget about Barron's and the Wall Street Journal and get over to the class reunion!

* *

The April 2 issue of the Wall Street Journal had to set some kind of record for rotten news. In this one issue we read (1) a $100 billion deficit is "almost unavoidable" for the Government. (2) Harvester told its creditors that it expects a loss of at least $518 million this year. (3) Construction spending fell 1% in February. (4) Auto output plunged 31% in the first quarter, the lowest level in 30 years. (5) The trustees of the Social Security System warn that under current law the program's retirement funds could run out of money by July, 1983. (6) GE is laying off 8500 workers at its major appliance plant in Louisville. (7)A&P is closing its food processing facility in Horsehead, NY, idling 480 workers. (8) Consumers' confidence sagged further in March, with the index down almost 7 points from February. Whew!

* *

Every time I pick up the paper I notice a new money market fund. Sears has one, the bank has one, the local butcher may start one. The New Yorker magazine seems to have noticed the same phenomenon. This cartoon tells the story.

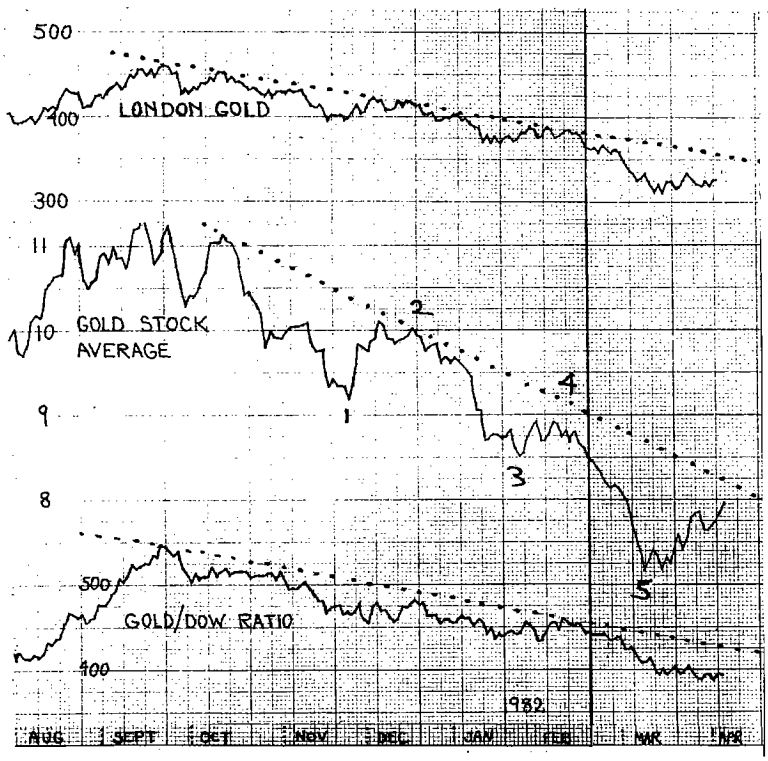
GOLD: The year's most predictable event occurred last week when the US Gold Commission pooh-poohed the idea of the gold-backed dollar. Why? Because, said the Commission, "there isn't enough gold." This idiotic argument sidesteps the concept of raising the price of gold to any level necessary to back all US currency. The Commission did advocate a US "gold coin" (not legal tender, of course). Why a coin? Who in hell knows? Obviously, politicians don't want to be disciplined by gold, and

gold will not enter the official system until dollars are driven out. But right now, the dollar is the hottest item around (except for Pac-Man video cartridges), and dollars pay 13-15% interest. So gold will have to wait its turn.

Gold recorded a London fix low of 312.50 in March, and it has not been lower since. That has turned a lot of hard money boys bullish, but the gold market has said, "Nothing's been proved yet." Study my three-part chart on this page. Note that the gold stock average has traced out a distinctive 5 leg decline, and I have numbered the decline 1 through 5. This is often (but not always) an indication of a completed move. Thus, I label the gold stock average "hopeful." At a value of 8.25 the gold average will reverse to the upside. But that hasn't happened yet.

At the bottom of the chart we see the ratio of gold to the Dow (gold divided by the Dow). It's been my experience that really profitable moves in gold only come when this ratio is in a rising trend (in favor of gold over the Dow). The ratio has been declining for eight consecutive months, which is a long time. But the ratio has not yet bettered its declining trendline–and therefore the climate is not yet right for gold bulls.

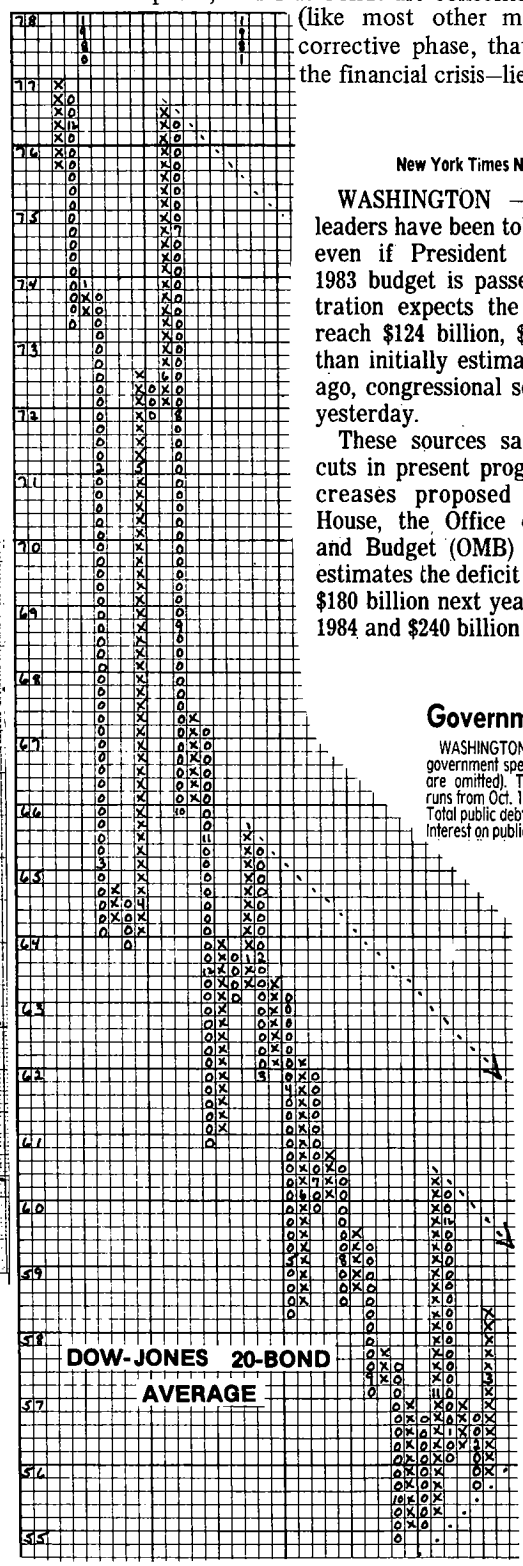
Conclusion: things are looking better for gold. Gold has held above its 312.50 lows for weeks. Gold might, it just might be moving into position for buying. But not yet; it's not time for gold–yet.



LATE NOTES: I want to state again that the finances of the US Government remain completely out-of-control. The smaller clipping (right column) shows that the Federal debt has now jumped $62 billion above the trillion market, and the total is exploding almost monthly. The debt of the US is being financed at around 13% average yields. This means that the INTEREST on the Federal debt will shortly total about $135 billion or $2.3 billion a week!

The deadly fact is that our leaders are not addressing themselves to the problem. The problem is that expenses MUST be cut in a massive way–ALL expenses, military, Social Security, pensions. But this will not happen, in my opinion, until the crisis hits. The crisis is going to be one of unprecedented proportions. It's going to be a monster. It's going to throw all markets into total panic.

This P & F chart (courtesy Chartcraft, Larchmont, NY) shows what has happened to the widely-followed D-J 20 Bond Average. The most recent smash took the Average from a 1979 high of 77 to a 1981 low of 55. From there it rallied to just over the 60 level. As of now the 20-Bonds are at 58.25, still well under the downtrend from the 60.20 level. Nothing has been proved from bullish standpoint, as far as bonds are concerned. The 20-Bonds (like most other markets) are in a corrective phase, that's all. The crisis, the financial crisis–lies ahead.



New York Times News Service

WASHINGTON — Congressional leaders have been told privately that even if President Reagan's fiscal 1983 budget is passed, the administration expects the 1983 deficit to reach $124 billion, $32 billion more than initially estimated eight weeks ago, congressional sources disclosed yesterday.

These sources said that without cuts in present programs or tax increases proposed by the White House, the Office of Management and Budget (OMB) now informally estimates the deficit would run about $180 billion next year, $220 billion in 1984 and $240 billion in 1985.

Government Finances

WASHINGTON (AP) – Here are figures on government spending and debt (last six digits are omitted). The government's fiscal year runs from Oct. 1 through Sept. 30.

Total public debt March 31	1,062,223
Interest on public debt Feb	8,482

NEXT MAILING: APRIL 21, 1982